



Irving Trust

Financial Markets

Irving Trust Company
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Economic Research &
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(Noon)

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On July 25 Mr. Volcker delivered his second and final "Humphrey-Hawkins" testimony for 1984, and the markets responded quite favorably--rightly so. In this testimony Mr. Volcker revealed that several problems that previously were bothering the credit markets had been removed. Also, the Fed has taken actions recently that have reinforced the notion that rates can go lower by registering lower adjusted borrowed reserve numbers in the statistics of recent weeks (for two consecutive weeks, borrowings less extended credit have dropped to around \$700 million from the \$1 billion level). Thus a near-term rally seems to be well established.

Technically Mr. Volcker has said several things that brighten the outlook for lower rates. First, he has registered approval that both M1 and M2 have been within their target ranges this year. This seemingly innocuous statement fails to note that M1's velocity has been rising and that M1 is in the upper portion of its target range. Previously Mr. Volcker had indicated that under such conditions the Fed would seek to keep M1 at or below its target mid-point. This is no longer true. Second, he noted that both the credit aggregate and M3 were growing at rates that were too fast, even after accounting for some special factors that bloated credit growth. Yet the Fed failed to set new targets for these aggregates and noted that the targets for M3 and especially that for credit very likely would not be hit. Thus the Fed seems to be saying that monetary policy will not be used to force these aggregates into their ranges. Coupled with the "new view" on M1, this is bullish news. However, in the background there are also less bullish statements.

I attended Mr. Volcker's testimony, and the tone was bullish in comparison with February's session. The above noted changes also are bullish. But the core of his testimony was unchanged: Progress on inflation appears to be good, but budget deficits still are a problem. Most troubling is a passage in the testimony that states that monetary policy has been roughly unchanged since late winter and early spring. Yet during this time span interest rates rose! Fed funds rates climbed from 10% to 11½%. And this certainly isn't a bullish factor, quite the contrary.

Previously most would have assumed that an unchanged Fed policy meant unchanged interest rates; no longer. While it may look like the Fed has been pegging interest rates, that is not true either. It has been smoothing rates and targeting adjusted gross borrowings. Thus interest rates are determined by the economy. In choosing not to target Fed funds, market forces have been allowed to impact market rates quite apart from Fed policy. Thus the Fed views steady borrowings of about \$1 billion at the discount window (excepting Continental Illinois) as even-keeling. Strong credit demands turned this procedure into one that produced higher rates. Thus a neutral Fed policy does not necessarily bring the low rates and the good news for the bond market that it once did. Still the market rallies with the Fed's help. But very clearly there will come a day of reckoning.

Robert A. Brusca



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Market Yields

	7/27/84 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	13.00%	13.00%	10.50%
Effective since	6/25/84		
Discount Rate at Federal Reserve Bank	9.00	9.00	8.50
Federal Funds	11.25	11.00	9.50
Repurchase Agreements	10.80	10.65	9.13
U.S. Treasury Issues			
Bills			
3 months	10.66	10.52	9.50
6 months	11.25	11.25	9.97
1 year	11.75	11.93	10.35
Coupons			
2 years	12.57	12.73	10.91
4 years	12.77	13.09	11.37
7 years	12.93	13.23	11.62
10 years	12.92	13.24	11.66
Long Bond	12.83	13.08	11.68
Negotiable Certificates of Deposit-Secondary Market			
1 month	11.05	11.15	9.45
3 months	11.30	11.50	9.60
6 months	11.70	12.05	10.15
1 year	12.35	12.70	10.55
Banker's Acceptances			
1 month	11.15	11.34	9.40
3 months	11.58	11.74	9.70
6 months	11.94	12.28	10.17
Eurodollar Deposits			
1 month	11.38	11.56	9.75
2 months	11.44	11.75	10.00
3 months	11.63	11.93	10.13
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies:			
1 week	10.92	10.67	9.40
1 month	11.20	11.31	9.45
3 months	11.20	11.25	9.74
Bank Holding Companies			
1 month	10.74	11.00	9.19
Dealer Placed:			
3 months	11.68	11.84	9.63
New AA Corporate Utility Bond	14.05	14.38	13.00
Tax Exempt			
6 month Project Notes	5.80	5.85	4.95
1 year AAA Bond	6.35	6.40	5.50
5 year AAA Bond	8.00	8.05	7.00
20 year AAA Bond	10.00	10.00	9.30

This information represents prevailing market yields.
It should not be construed as an offering.
 All yields are on the offered side of the market.

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